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C O N F I D E N T I A L SECTION 01 OF 03 BAKU 000431

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DEPARTMENT FOR EUR/SNEC AND EB/ESC
USDOE FOR FE - SWIFT AND OS - WILLIAMSON

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SUBJECT: EUR A/S FRIED DISCUSSES ENERGY SECURITY ISSUES IN BAKU

Classified By: Ambassador Reno L. Harnish, III, reasons 1.4 (b), (d) and (e).

11. (C) SUMMARY. EUR A/S Fried discussed the role of the Caspian in European energy security with GOAJ, BP, TOTAL, Statoil and ConocoPhillips officials in Baku on March 14. The consensus opinion was that Caspian energy resources, particularly natural gas, could play an important role in meeting future European energy needs. While the lack of final agreements on Caspian demarcation may not prevent future projects, EU anti-competition laws could pose serious obstacles to bringing Shah Deniz gas into Europe. The GOAJ representative strongly argued for bringing Turkmenistan's gas across the Caspian and into Europe. The GOAJ's optimistic prediction of an early signature on an agreement to bring Kazakhstan's oil into the BTC oil pipeline was privately disputed by company representatives. Delays in Turkey over the completion of the BTC oil and SCP gas pipelines were also discussed. END SUMMARY.

12. (U) On March 14, Ambassador hosted a lunch for EUR A/S Daniel Fried on the theme of energy security. Ambassador, EUR/SNEC Special Negotiator Ambassador Mann, EUR/CARC Director Rood, EUCOM J5 Eurasia chief COL Anderson and Embassy Baku energy officer were also present. Attendees were:

--David Woodward, BP Azerbaijan
--Thierry Normand, TOTAL
--John Dabbar, ConocoPhillips
--Jan Heiberg, Statoil
--Araz Azimov, Deputy Foreign Minister of Azerbaijan

13. (C) A/S Fried began the lunch by noting how energy security and diversification of supply had become topical in Europe and the United States following the Ukrainian gas crisis. The United States government does not build pipelines or choose their routes, Fried noted, but does want to support projects that increase diversity of supply and that make commercial sense. The United States discusses energy security with the EU and would discuss it at NATO on March 16. He asked the assembled guests how they see Caspian energy resources fitting into this picture.

EU REGULATORY ISSUES

14. (C) David Woodward sketched a general picture of Europe's gas needs in the future -- something like 800 bcma will be required by 2025. Much of this will come from North Africa, from imported LNG, from Russia and from Norway, but there is a gap of about five to ten percent which Caspian resources could fill. Azerbaijan would be a part of this, but so would other Caspian states. Woodward estimates that Shah Deniz could provide as much as 20 bcma to European markets, but the EU's anti-monopoly regulations would make this difficult. These regulations would prohibit the Shah Deniz partners from selling their gas jointly. Jan Heiberg echoed this, stating that breaking the Shah Deniz partnership into seven individual gas streams to send all the way to Europe is "crazy" and this may prevent Shah Deniz gas from getting into Europe at all.

15. (C) Woodward noted that the regulations can theoretically be waived if it can be demonstrated that there are "no alternate means" to getting the gas into Europe, but that this is a very arduous test to meet. Changing this regulation would have "huge implications" and is not something that would be done lightly. The regulation has been applied in the past to derail or substantially rework projects aiming at the import of Norwegian gas and of Algerian gas. TOTAL's Thierry Normand said that this is true, but pointed out that in a case of diminishing supply and increasing need, perhaps the EU's attitude would change.

CASPIAN DELIMITATION ISSUES

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16. (C) John Dabbar noted that accessing Central Asian gas resources will require subsea pipelines in the Caspian, but that runs into the issue of Caspian delimitation. The absence of final agreement on same would prevent the construction of such pipelines, he said. However, Central Asian gas could be a substitute for Russian gas -- the Russians could buy Central Asian gas cheap and then resell it at a huge markup to European markets, saving themselves the considerable expense of developing gas resources in the far north of Russia.

17. (C) Ambassador Mann pointed out that Caspian delimitation issues need not block projects -- the USG position is that only the consent of the participating countries is necessary to move a project forward. In 1998, the ultimately ill-fated Turkmenistan-Azerbaijan gas pipeline project (TCP) was ready to proceed with only Turkmenistani and Azerbaijani assent. The Russians, Mann added, built Blue Stream after consulting only with Turkey. The Caspian has been delimited, said Mann, it's just that Turkmenistan and Iran refuse to acknowledge this fact. Deputy Foreign Minister Azimov agreed and pointed out that Turkmenistan came close to agreeing with Azerbaijan on Caspian delimitation in 1996-1997, but while it never signed the agreement, it never rejected it either.

ACCESSING TURKMENISTAN'S GAS

18. (C) Woodward noted that Turkmenistan could ship its gas eastward as easily as westward, and that no foreign companies are currently engaged in developing Turkmenistan's gas. Most of Turkmenistan's gas volumes appear committed to Russia now, but, Woodward noted, these kind of contracts with Turkmenistan often don't last. Ambassador Mann noted that Turkmenistan tends to write thirty-year contracts that involve renegotiations of price every eighteen months.

19. (C) Deputy Foreign Minister Azimov argued that there is a strong strategic case for bringing Turkmenistan's gas into

Europe. While Turkmenistan may want to send its eastern gas to Asian markets, this will not prevent efforts to bring its western gas to Europe. Using the Azerbaijan-Georgia corridor, said Azimov, several routes are possible. Through Turkey and Greece to Italy, for example, or across the Black Sea to Romania and Bulgaria. Most interesting, said Azimov, is the idea to get Turkmenistan's gas into Ukraine, and thence onward to Poland and Germany. As Russia's gas policy is not likely to change, said Azimov, it is vital to bring Turkmenistan back into the game.

ACCESSING KAZAKHSTAN'S GAS AND OIL

¶10. (C) The issue of bringing Kazakhstan's gas across the Caspian was also raised, but the quick consensus from industry representatives was that this is unlikely in the near-term. David Woodward noted that Kazakhstan's gas reserves are mainly associated gas linked to large oil or oil-and-gas fields with high levels of hydrogen sulfide. Much of this gas is planned to be reinjected to boost oil production, he added, although it is possible that as the oil fields reach the ends of their operational lifetimes, someone will think about exporting the gas. However, this would require Kazakhstan to "shift from seeing gas as a nuisance to seeing it as a commodity."

¶11. (C) The question of cross-Caspian transport of Kazakhstan's oil is of much greater saliency. Deputy Foreign Minister Azimov asserted that Kazakhstan had brought its final version of the Inter-Governmental Agreement (IGA) for this project to Baku and that differences between the two sides are very slight. Azimov added that Kazakhstan was showing interest in the GUAM organization as a way to bring its energy resources westward. John Dabbar asked Azimov if Azerbaijan has changes of its own to propose to the IGA. Azimov replied that Azerbaijan's Ministry of Energy has

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already responded to Kazakhstan and that there are only a few changes. Thierry Normand said that he hopes this is a sign that the IGA will be signed soon. When asked, Dabbar said that the north Caspian producers expect Kazakhstan's Kashagan field to begin producing by the end of 2008 or early 2009. If the legal and physical infrastructure for transport of this oil to BTC is not ready by then, the north Caspian producers will either send the oil through CPC or through the Aterau-Samarra line, with a final backup plan of sending the oil by rail to the Black Sea. NOTE: Immediately following the lunch, both Dabbar and Normand pulled energy officer aside and told him with great urgency that they feel Azimov is extremely optimistic in his assessment of progress on the IGA. In their view, Azerbaijan and Kazakhstan are still very far apart on key issues and a signature in the near future is very unlikely.

PROGRESS AND PROBLEMS WITH BTC AND SCP IN TURKEY

¶12. (C) A/S Fried asked about progress and problems with the BTC and SCP projects. Woodward was extremely critical of Turkey and said that BTC has suffered a 400-day delay in completion. The key factor, said Woodward, is that when the BTC project was negotiated, Turkey asked for a very low cost ceiling, and when BP demurred, the lump-sum turn-key agreement was created under which the Turkish state pipeline concern BOTAS would complete the BTC line for that amount, with completion guarantees issued by the Government of Turkey. However, says Woodward, BOTAS has now taken the position that these guarantees were issued by a previous government and are no longer valid, therefore BP must pay for the cost overruns. Woodward says there have been huge and repeated changes in the senior management of BOTAS, serious questions of managerial competence, and criminal charges

against executives appointed by earlier governments. The result has been what Woodward terms a hypercautious attitude by current management that contributes to further delays.

¶13. (C) The picture, according to Woodward, is unfortunately not much better with regards to completion of the SCP gas pipeline. SCP was structured differently from the way BTC was, in that the Shah Deniz partners sell the gas to Turkey at the Turkish-Georgian border. It is up to Turkey to construct its own pipeline to Erzerum and construct a compression station there, said Woodward. There have been serious delays with both these projects as well, prompting both Azerbaijan and Georgia to propose taking the gas themselves for domestic use. This is not realistic, says Woodward, as the gas was sold to Turkey at extremely competitive rates. It is difficult for BP to know where the decisions are really being made in Turkey. Energy Minister Guler has been supportive as an individual but this has rarely translated to progress, Woodward says, as the BOTAS project director often does not follow the direction of the Minister. Woodward opined that the BOTAS project director fears liability and does not trust the Ministry to protect him in the event of future legal action. Woodward says that Turkey should be using these projects to demonstrate its reliability as a energy-transit country, but so far this perspective has not been enough to motivate change.

¶14. (C) In concluding the lunch, A/S Fried thanked the participants for attending and for their thoughts. The United States wants to see multiple, competitive routes for energy into Europe in order to assure diversity of supply, he said. The United States will continue to work with Europe to bring this about.

¶15. (U) A/S Fried has cleared this cable.
HARNISH